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Slump Moves From Wall St. to Main St.

By Peter S. Goodman

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In Seattle, sales at a long-established hardware store, Pacific Supply, are suddenly dipping. In Oklahoma City, couples planning their weddings are demonstrating uncustomary thrift, forgoing Dungeness crab and special linens. And in many cities, the registers at department stores like Nordstrom on the higher end and J. C. Penney in the middle are ringing less often.

With Wall Street caught in a credit crisis that has captured headlines, the forces assailing the economy are now spreading beyond areas hit hardest by the boom-turned-bust in real estate like California, Florida and Nevada. Now, the downturn is seeping into new parts of the country, to communities that seemed insulated only months ago.

The broadening of the slowdown, the plunge in home prices and near-paralysis in the financial system are fueling worries that what most economists now see as an inevitable recession could end up being especially painful.

Indeed, some economists fear it will last longer and inflict more bite on workers and businesses than the last two recessions, which gripped the economy in 2001 and for eight months straddling 1990 and 1991. This time, these experts say, a recession in which economic activity falls over a sustained period and joblessness rises across the board could even persist into next year.

“It’s not hard to construct very dark scenarios, primarily because the financial system is in disarray, and it’s not clear how to get it all back together again,” said Mark Zandi, chief economist at Moody’s Economy.com.

To be sure, there are many places where talk of recession still seems as out of place as a diner trying to score a table at a trendy Los Angeles restaurant without reservations on a Saturday night. First-class cabins of airplanes are jammed. So are spas, cigar bars and children’s clothing boutiques selling upscale dresses.

Unemployment, meanwhile, still remains at a relatively low 4.8 percent.

But even after the Federal Reserve’s extraordinary efforts to prevent the collapse of Bear Stearns from spreading to other financial institutions, the danger still lurks that banks will grow even tighter with their funds and will starve the economy of capital.

“If lenders and debtors don’t trust each other, that causes a power outage,” said Michael T. Darda, chief economist at MKM Partners. “And that’s where we are now.” Until recently, Mr. Darda was among those still holding to the notion that the economy could generate enough jobs to keep the economy rolling. But the private sector has shed jobs for three consecutive months. Mr. Darda is now worried.

“We’ll be lucky to make it out of this without something that looks like a recession,” he said.

On Thursday, FedEx , whose global courier business tends to rise and fall with swings in the economy, reported that its earnings actually dropped in the United States and warned that in future months it expected to fall well short of its customary double-digit annualized profit gains.

“We just aren’t going to be able to do that,” Alan Graf, FedEx’s chief financial officer, said in a call with Wall Street analysts. “The crystal ball for everybody is very cloudy here.”

For now, there are still pockets of prosperity across the country. Farmers are enjoying record crop prices as the adoption of ethanol makes corn a way to fill gas tanks, and as rising incomes in China, India and elsewhere spell growing demand for meat. The weak dollar is helping exporters and retailers that cater to foreign tourists.

Eastern Mountain Sports, the outdoor clothing dealer, says sales increased by one-third this month compared with the year before at its store in SoHo. “A lot of that is Europeans coming over,” said Will Manzer, the company’s president.

With oil selling at approximately \$100 a barrel, the Taste of Texas Steakhouse in Houston — a popular spot for events held by BP, Shell and Exxon Mobil — is reveling in days of plenty.

Even those areas suffering the downturn can bank on considerable help on the way, economists say, as the impact of lowered interest rates kicks in later this year, encouraging businesses to expand and hire. Tax rebate checks to be mailed out by the government this spring may lubricate spending as well.

Despite fears that the odds for a particularly severe recession have now increased, Mr. Zandi still subscribes to the consensus that the economy will shrink only modestly during the first half of 2008, then resume expanding as more money washes through the system. That would limit the damage to the type of relatively modest recession that hit the economy earlier this decade.

For the country as a whole, recent data shows that the economy is deteriorating at an accelerating rate. From September to January, average home prices fell 6 percent compared with a year earlier. Consumer confidence has been plummeting. The private sector shed 26,000 jobs in January and 101,000 in February, while those out of work have stayed jobless longer, according to the Labor Department.

Now, the broader discomfort is filtering into cities and towns that only recently seemed beyond reach.

Seattle's real estate market has slowed, but prices have held relatively steady. Even so, sales at the Pacific Supply Company, a hardware store in the Capitol Hill neighborhood, have fallen by 5 to 10 percent in the last few months.

"There's a general sense of caution," Michael Go, the store's general manager, said.

Ritz Sisters sells gift items like soaps and chocolates to shops and catalogs throughout the Pacific Northwest. In recent months, orders have fallen by one-fifth, said Tim Creveling, a co-owner of the business.

"People are just hunkering down," he said.

In Oklahoma City, Aunt Pittypat's Catering has lost one-fifth of its business in the last two months, as \$25,000 weddings are scaled down to smaller affairs.

"People are just being a lot more conservative," said Maggie Howell, a co-owner. "They want crab and seafood, but they're settling for cheese displays."

In Cleveland, Lincoln Electric, which makes welding gear, has also experienced a slowdown. "Our growth is relatively anemic in North America," said Vincent Petrella, its chief financial officer.

The slowdown has proved severe enough to poke a hole in the idea that sales abroad can carry the economy even if they dip at home.

In North Carolina, Power Curbers, which makes equipment that turns concrete into curbs, has been sending more gear abroad. But domestic sales plummeted by one-fourth during the first two months of the year, Dyke Messinger, the company's president, said. In mid-February, Power Curbers laid off 6 of the 80 workers at its factory near Charlotte.

Many economists forecast that overall consumer spending will slip 1 percent for the first three months of the year.

"That's a wow," said Robert Barbera, chief economist for the trading and research firm ITG. "Outright declines for real consumer purchases are unusual."

What is shaping up as the second recession of the 2000s is the product of declines in home values, which play a far bigger role in most Americans' personal finances than the stock market. Households have borrowed against the increased value of their property to buy cars, send their children to college and add home theater systems.

“This is the bedrock asset for the lion’s share of the population of the United States,” Mr. Barbera said. “It’s not like dot-com stocks, where I bought Webvan for 1,000 times the imaginary earnings, and now it’s worth nothing but I go and have a beer. You’re talking about the value of people’s houses.”

As economists try to assess the likely contours of the unfolding downturn, many see parallels in the recession of 1990 and 1991.

Then, as now, the dollar was weak, oil prices were high and trouble started with a sharp slide in housing prices, followed by major losses for mortgage lenders. The resulting savings and loan crisis spurred a buyout that cost taxpayers \$240 billion in inflation-adjusted terms, and it brought a severe tightness of credit.

That recession lasted eight months, slightly less than the average for downturns going back to 1946, according to the National Bureau of Economic Research. This one, though, could drag on longer, some economists say, because the underlying forces are more difficult to attack, even though Washington has been much more active, much earlier in lowering interest rates, sending out tax rebates and taking other measures to arrest an economic decline.

Back in the late 1980s, lending was concentrated in fewer hands. Once the government calculated the size of the problem in the saving and loan industry and assented to the bailout, confidence was restored and the wheels of finance turned anew.

This time, the size of the bad debts remains a mystery, with estimates reaching \$400 billion. Markets fret that the next Bear Stearns could pop up anywhere.

The first signs of what became the mortgage crisis emerged back in August.

“Yet we’re still fighting it,” Mr. Darda said. “We’re still dealing with this paralysis.”